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In The

Supreme Court of the United States

October Term, 1991

COMMONWEALTH OF VIRGINIA,
DEPARTMENT OF TAXATION,

Petitioner,

v.

CORNING, INC.,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of Virginia

REPLY BRIEF FOR THE PETITIONER

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INTRODUCTION

Pursuant to this Court's Rule 15.6, the Attorney General of Virginia, on behalf of the Commonwealth's Department of Taxation ("Virginia"), respectfully submits this Brief in response to the Brief In Opposition ("Opposition") to its Petition for Writ of Certiorari ("Petition") that was filed by Corning, Inc. ("Corning"). With respect to matters not addressed herein, Virginia relies on its Petition.

Virginia's Petition argues that certiorari is appropriate because the Supreme Court of Virginia applied an erroneous legal standard in reversing the judgment of the state trial court. That erroneous legal standard, Virginia argued (Pet. 8-14),[1]

[1] "Pet.," "Pet. App.," "Opp." and "Am. Br." references are to Virginia's Petition, the Appendix to Virginia's Petition, Corning's Opposition and the supporting States' Amicus Brief, respectively.

directly conflicts with the decisions of sister state appellate courts and erroneously resolves important federal constitutional issues left open in *ASARCO, Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982) ("*ASARCO*").

Twenty states joined an amicus brief filed by the State of Maryland supporting Virginia's Petition for Certiorari. Like Virginia's Department of Taxation, tax officials in these states need authoritative guidance from this Court on the proper scope and application of this Court's decision in *ASARCO* to income from intangibles.

I. Virginia And Twenty Amici States Seek Certiorari To Resolve Important Issues Of Federal Constitutional Law Affecting The Taxation Of Multistate Corporations That Receive Income From Intangibles

Corning's opposition essentially fails to respond to Virginia's and amici's argument that the Supreme Court of Virginia misinterpreted *ASARCO* to prescribe a single bright-line test for determining the apportionability of income from intangibles. Instead, Corning disingenuously attempts to downplay the significance of this case by suggesting (Opp. 3) that the Virginia Supreme Court made a "fact-specific" determination.[2] Corning is wrong. The Virginia Supreme Court reversed the trial court's fact-specific determination based on its view of the law, specifically its interpretation of *ASARCO*. The Virginia Supreme Court interpreted *ASARCO* to mandate application of a single bright-line test requiring a unitary business relationship between the income-payor and the income-recipient *regardless* of where the income-payor

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[2] The significance and general applicability of this case were obvious to Corning and members of the business community in seeking reversal of the Virginia trial court's decision. The Committee on State Taxation of the Council of State Chambers of Commerce ("COST") and two major corporations, W. R. Grace & Co. and Lorillard Inc., filed amicus briefs supporting Corning's position in the Virginia Supreme Court.

does business and *regardless* of the function of the income-producing asset or activity in the taxpayer's unitary business.[3]

Virginia and amici seek review by this Court not to argue about disputed facts but to obtain guidance concerning the legal standards applicable to apportioning income from intangibles. The only "fact" relied on by the Virginia Supreme Court was the undisputed fact that a 1949 federal antitrust consent decree prevented Corning from directly controlling Owens Corning Fiberglas Corporation ("OCF"). The Virginia Supreme Court held this single, undisputed fact controlling because it misread *ASARCO* to ignore all other facts. But, as Virginia and its twenty amici states agree (*see* Am. Br. 9-12), this single fact alone cannot legally be controlling unless the unitary business inquiry focuses solely on the relationship between the income-payor and the income-recipient. It does not.

II. The Virginia Supreme Court Applied An Erroneous Legal Standard That Directly Conflicts With The Decisions Of Other State Courts Of Last Resort

Virginia and amici seek an affirmation by this Court that there are at least two tests governing the apportionability of income from intangibles, *i.e.*, such income is apportionable if either the income-producing asset or activity is part of the taxpayer's unitary business or the taxpayer and the income-payor corporation are a part of a larger unitary business. *See* Pet. 17-18; Am. Br. 9.

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[3] Corning's suggestion (Opp. 5) that the Virginia Supreme Court "fully considered" the issues before it ignores the fact that the court's opinion does not even mention the contrary state appellate decisions and commentators supporting the trial court's decision. *Compare Pledger v. Illinois Tool Works, Inc.*, No. 90-242, slip op. (Ark. Sup. Ct. June 24, 1991) (1991 ARK LEXIS 333) (Hays, J. dissenting) (recognizing unsettled state of cases). Corning's assertion (Opp. 5) that the Virginia Supreme Court "correctly" decided the issues before it ignores the fact that the court's opinion erroneously cites *ASARCO* as concluding that *no* unitary business relationship existed between ASARCO and five wholly-owned and controlled subsidiaries. *See* Pet. App. 8.

Corning seeks to distinguish three of the state appellate court decisions supporting the trial court's finding that Corning's OCF investment was part of Corning's unitary business by asserting that these cases involve "short term investments of working capital" (*see* Opp. 4-5).[4] Corning's suggestion lacks merit. Nowhere do the appellate courts' opinions in these cases suggest that apportionability should depend on the duration of the asset holding period or the term of the deposit or loan generating the interest. Rather, the controlling facts were those concerning the *function* of the income-producing asset or activity and its relationship to other activities of the taxpayer's unitary business.[5]

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[4] Corning asserts (Opp. 4 n.5) that it need not respond to the many hopelessly conflicting lower state court decisions Virginia has cited (Pet. 9 n.10, 10 n.11, 12 n.13). Certiorari, of course, is appropriate in this case to resolve precisely such nationwide conflict.

[5] *See NCR Corp. v. Comptroller*, 313 Md. 118, 134, 140, 544 A.2d 764, 772, 774 (1988) ("the focus of the inquiry is on the relationship of the activity in question with the unitary business, not on the identity of the business payer"; "the investments which produced the DPI [interest income] . . . were actively monitored and carefully timed so as to meet NCR's operating needs"); *Silent Hoist & Crane Co. v. Director*, 100 N.J. 1, 19, 23, 494 A.2d 775, 784, 786, *cert. denied*, 474 U.S. 995 (1985) ("[t]he focus must be on Silent Hoist's investment activity and other aspects of its corporate business and the role the investment activity plays in those other activities"; "We are more than satisfied here that there was a distinct sharing of the value of common management, accounting and operations that takes the portfolio income of this taxpayer well within the concept of a unitary business"); *Lone Star Steel Co. v. Dolan*, 668 P.2d 916, 925 (Colo. 1983) (Lone Star "is engaged in only one business – the integrated steel business – and it lends money to its parent in furtherance of the goals, and to aid the operations, of its unitary business").

Corning seriously misstates the holding of the Missouri Supreme Court in *Williams Cos. v. Director*, 799 S.W.2d 602 (Mo. 1990), *cert. denied*, 59 U.S.L.W. 3866 (U.S. Sup. Ct. June 28, 1991), with respect to the capital gains income at issue in that case. The capital gains arose from the sale of stock in a separate corporation (Wood River Pipeline Company), which was formed as a joint-venture between the

(Continued on following page)

Indeed, Corning's concession that short-term investments of working capital produce apportionable income is fundamentally inconsistent with Corning's position that *ASARCO* prescribes a single bright-line unitary income-payor/recipient test. The apportionability of such income derives not from the short-term nature of the investment or the identity of the income-payor, but from the direct relationship between the investment activity and the operation of the business. Moreover, the *longer* the holding period, the more likely it is that the asset is related to or utilized in the operation of the business, facts the Court in *ASARCO* indicated *could* establish a unitary business relationship. *See* 458 U.S. at 325 n.21.

The error of Corning's reasoning is demonstrated by the recent opinion of the New Jersey Supreme Court in *Bendix Corp. v. Director,* No. A-47, slip op. (N.J. Sup. Ct. July 16, 1991) (1991 NJ LEXIS 72) ("*Bendix*"), which sustained the very position urged by Virginia and amici here. Affirming the lower courts' conclusion that the capital gains and interest income of a nondomciliary corporation from the sale of its minority (20.6%) stock interest in ASARCO, Inc. was includable in New Jersey's apportionable income base,[6] the New Jersey Supreme Court stated:

(Continued from previous page)

taxpayer and a Minnesota refinery operator (Koch Industries, Inc.). 799 S.W.2d at 606. The taxpayer Williams Pipeline Company did not actually control or operate Wood River Pipeline Company, but instead held preferred stock that was ultimately sold to the other joint venturer (Koch). The Missouri Supreme Court held that the capital gains income was apportionable because "[the taxpayer] Williams Pipeline Company's *interest* in Wood River Pipeline Company *was a part of Williams Pipeline Company's unitary business.*" *Id.* at 607 (emphasis added).

By contrast, certain interest income from short term loans to parent companies was held apportionable because the taxpayers conceded that the parent company payors were all part of the same unitary business. *Id.* at 606. The *Williams Cos.* case, therefore, supports Virginia's and amici's position that there are a number of nonexclusive tests governing the apportionability of income from intangibles.

[6] *See Bendix Corp. v. Director,* 10 N.J. Tax 46 (1988), *aff'd,* 237 N.J. Super. 328, 568 A.2d 59 (1989).

> [T]here are a number of nonexclusive tests utilized to determine the existence of a unitary business.
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> * * *
>
> The tests for determining a unitary business are not controlled . . . by the relationship between the taxpayer recipient and the affiliate generator of the income that becomes the subject of State tax. As has been emphasized, there is no bright line controlling test. What controls is the underlying activities that reflect the economic realities of the corporate business.
>
> * * *
>
> Bendix, during the period under review, essentially had a business function of corporate acquisitions and divestitures that was an integral operational activity.
>
> * * *
>
> When capital investment activities are long-term integral operational corporate functions rather than passive investment functions, they can serve as the basis for concluding a unitary business exists.

Bendix, slip op. at 16, 18-20.[7]

Like Bendix's interest in ASARCO, there can be no doubt that Corning's interest in OCF was part of Corning's unitary business, as the Virginia trial court correctly found. As the listing of parties on pages ii and iii of Corning's Opposition indicates, one of the principal activities of Corning's unitary business is investing in subsidiary and associated companies. *See Corning's Class Act – How Jamie Houghton Reinvented the Company*, Bus. Wk. 68-76 (May 13, 1991). Corning did not establish a separate holding company for this purpose, but has always conducted its stock ownership activities as an indivisible part of its unitary business.

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[7] The New Jersey Supreme Court also sustained the apportionability of capital gains and interest from Bendix's sale of its 100% stock ownership in United Geophysical Corporation ("UGC"). *See Bendix*, slip op. at 8-10, 23. *Compare id.* at 8 (noting that Bendix and ASARCO "shared no common officers, employees, office space, or legal services" etc.).

The OCF stock was a fundamental part of Corning's operating strategy for nearly half a century. It is not merely the size of the OCF investment (it constituted about one-sixth of Corning's net worth over a thirty-year period), but also the continuity and regularity of Corning's stock investment activities and its dependence on those activities to support and expand its core glass manufacturing business that fully support the trial court's finding of apportionability. As the majority in *ASARCO* stressed, the facts found by the trial court in that case were entirely different:

> The trial court, however, found that ASARCO "has never been required to utilize its stock as security for borrowing of working capital, acquiring stock or securities in other companies or to support any bond issues." Moreover, ASARCO was found to have "sufficient cash flow from mining to provide operating capital for all mining operations without reliance upon cash flow from . . . income from intangibles."

458 U.S. at 325 n.21 (quoting from the trial record).

III. There Is A Significant Need For Clarification Of The Scope Of *ASARCO* And The Due Process Legal Standards Governing The Apportionability Of Income From Intangibles

As noted, Corning's basic response strategy is to deny the significance of this case.[8] Rather than respond to Virginia's

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[8] Corning also seeks to downplay the significance of OCF's operation in Virginia (*see* Opp. 7 n.11). But *ASARCO* is by its terms inapplicable to income paid by corporations operating within the taxing state. *See ASARCO*, 458 U.S. at 308-09. The undeniable fact of OCF's operation in multiple states, including Virginia, Ohio and New York, demonstrates the unreasonableness of the result reached by the Virginia Supreme Court. As Corning cannot deny, New York does not fully tax income from intangible assets. *See* Pet. 16 n.16. Thus, Corning does not suggest that New York fully taxed the income in question or that Virginia and New York together seek to tax more than 100% of the capital gains and interest. Rather, Corning asks this Court to deny certiorari by constructing "straw man" arguments that grossly oversimplify and misstate Virginia's and the amici's position – there is no single bright-line test for determining the apportionability of income from intangibles.

argument that Corning's stock ownership activities, including its activities with respect to the OCF stock, served an operational function in Corning's unitary business, Corning instead asserts (Opp. 8) that Virginia's reliance on the "importan[ce]" of the capital gains and interest income in Corning's corporate strategy amounts to no more than a "business purpose" test rejected in *ASARCO* and a companion case, *F.W. Woolworth Co. v. Taxation and Revenue Dep't.*, 458 U.S. 354 (1982). Corning's argument not only overlooks significant activities *preceding* the sale of the OCF stock, but also a significant legal development, *i.e.*, this Court's explicit recognition in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159 (1983) ("*Container*"), that capital transactions may serve an *operational function*. *See* 463 U.S. at 180 n.19. *Accord Bendix*, slip op. at 20.

The reason for Corning's silence on these points is obvious. Corning cannot deny what the record clearly establishes: that Corning's stock ownership activities, including its activities with respect to the OCF stock, served a variety of key operational purposes in Corning's unitary business, such as issuing debt, repaying loans, diversification, cyclical protection, expansion into new product lines, funding programs in glass and ceramics, technological development and financing a major corporate reorganization. *See* Pet. 9 n.9.

To describe these integral business activities as "passive ownership of stock in a discrete business enterprise" (*see* Opp. 5) not only ignores reality, it fundamentally distorts the purpose of the unitary business concept. The concept is not a sword to enable taxpayers to carve out exemptions for major accretions to wealth such as the capital gains and interest exceeding $100 million at issue here. The concept is designed to facilitate legitimate state taxation by freeing states from the artificial constraints of geographical or transactional accounting. *Container*, 463 U.S. at 165.

Capital stock investments that serve an operational function in the investor's unitary business (*e.g.*, obtaining loans for operating capital, supporting bond issues or acquiring

stock or securities in other companies) provide income that is fully apportionable. *See ASARCO*, 458 U.S. at 325 n.21; *Container*, 463 U.S. at 180 n.19. As the New Jersey Supreme Court recently concluded, "[w]hen capital investment activities are long-term integral operational corporate functions rather than passive investment functions, they can serve as the basis for concluding a unitary business exists." *Bendix*, slip op. at 20 (citing *Container*). *See Container*, 463 U.S. at 166 (unitary business relationship between in-state and out-of-state activities is established by "some sharing or exchange of value . . . beyond the mere flow of funds arising out of a passive investment or a distinct business operation"). *See also supra*, note 5.

In this case, Corning wholly failed to, and indeed could not, meet its burden of proving that it had no need to rely on the OCF stock investment, which accounted for one-sixth of Corning's net worth over a 30-year period and which was liquidated to finance a major restructuring of Corning's business. Corning's need for cash and its goal to reshape its operations, not the 1949 consent decree, compelled the liquidation, and the resulting income is fully apportionable.[9] The Virginia Supreme Court's contrary decision directly conflicts with the decisions of sister state courts of last resort. It creates an enormous state tax loophole by allowing corporations to use *ASARCO* as a sword to exempt income from intangibles from apportionment. Virginia and its amici urge this Court to grant a writ of certiorari to clarify the scope of *ASARCO* and provide authoritative guidance as to the standards applicable to apportioning income from intangibles.

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[9] As the Virginia Supreme Court's opinion acknowledges (Pet. App. 3), Corning *requested* that the consent decree be modified to require divestiture of 90% of its stock by 1986. Corning requested the modification because among other things, "an amendment to the Internal Revenue Code enacted since entry of the final judgment constitutes a significant change in circumstances warranting such modification." Motion for Modification of Final Judgment dated Sept. 8, 1978 (II Va. Sup. Ct. App. 428-29).

CONCLUSION

For the reasons stated in this Reply Brief, in Virginia's Petition and in the supporting States' Amicus Brief, Virginia's Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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